PORTUGAL'S ECONOMIC ELIGIBILITY FOR IBRD LOANS

Economic Department
Prepared by: Herbert W. Robinson
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<international bank for reconstruction and development>

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1. The purpose of this memo is to answer, without undertaking any detailed economic study, the two questions
   a) whether, if Portugal became a member of the Fund and Bank, the Portuguese Empire would be an appropriate field for Bank investment; and
   b) whether any condition exists which renders Portugal prima facie uncreditworthy.
   A) Is the Portuguese Empire an appropriate field for Bank investment?

2. The Portuguese Empire, comprising Portugal together with colonies in East Asia, India, E. Africa and W. Africa, has remained predominantly agricultural. The Portuguese population of 8-1/2 million (excluding the colonial population of 10.9 million) is one of the fastest-growing in Europe, having increased by over 40% in the last thirty years. Though, in the past, some outlet was found in emigration to Brazil, Portuguese colonies and the United States, agricultural and industrial production have barely kept pace with population growth, and the per capita national income is, even today, only about $100 per annum - lower than any other country in Europe with the possible exception of Spain. Although the country and its colonial Empire have very limited natural fuel and other mineral deposits, the Government has endeavoured since 1928 to raise the standard of living by developing the country's sizeable hydro-electric power potential, modernizing agriculture, developing industries, and exploiting the agricultural, coal and mineral resources of the colonies. Thus, it embarked before the war on a 15-year plan of industrialization and irrigation which, though interrupted by the war, has been revived in the form of a new 8-year plan. Apart from postponement of capital maintenance, Portugal,
as a non-belligerent, emerged unscathed from the war; moreover she had considerably augmented gold and foreign exchange reserves. On the basis of all these facts, it is clear that Portugal is best considered as distinct from a reconstruction area.

3. Portugal received no aid from ECA in 1948/49. In view, however, of the unexpectedly rapid depletion of her gold and foreign exchange reserves arising from greatly swollen imports, she has requested aid of $100.6 million to finance her gold and dollar deficit in 1949/50. This amount would enable her to continue the heavy imports of capital equipment which started as soon as the war was over ($164 million are allocated for such items in the proposed 1949/50 import program of $416 million). ECA have assumed, however, that "the more urgent replacements of capital goods not available during the war have been made ....... further imports of machinery would be principally for development purposes ....... only a part of this development could properly be considered to fall within the objectives of the European Recovery Program."

ECA have accordingly reduced the gold and dollar deficit in 1949/50 to $25 - 30 million by drastically reducing capital equipment imports. Moreover, they have argued that some of this deficit can be met out of the excess of gold and dollar holdings over prescribed Central Bank monetary reserves, and that gross dollar aid from ECA can, therefore, be restricted to $10 million.

4. Since reconstruction needs have now been met, and since ECA proposes to finance only "such development as will contribute directly to the ERP" the IBRD might regard some of the development projects deemed inappropriate by ECA as appropriate for Bank consideration.

5. Development projects in the Portuguese colonial empire might be particularly appropriate in view of the Bank's current interest in colonial development in Africa, where the Portuguese colonies occupy a strategic position.
In Mozambique and Angola there are important railroads and ports which even at present are serious bottlenecks in the development of exports from British and Belgian colonies.

B) Is there any apparent condition which renders Portugal un-creditworthy?

6. The main favourable and unfavourable features of Portugal's present economic and financial position are as follows:

1) Favourable Features

a) During the war increased exports of wolfram and tin, enforced curtailment of imports, and inflow of refugee capital, produced substantial payments surpluses which brought gold and foreign exchange reserves to $750 million by the end of 1946. Today, despite the use of these reserves to finance post-war payments deficits, they stand at about $550 million. While $245 million of this amount is in gold and dollars, some $305 million is in blocked sterling. These blocked balances can however, be used to some extent to finance expected deficits with the sterling area (some $36 million in 1949/50). Short-term dollars assets in the U. S. amount to some $35 million. Compared with total imports in 1948 of about $385 million, such reserves are very satisfactory.

b) Portugal's foreign debt is only $124 million, and of this $91 million is sterling World War I debt on which payments were suspended in 1932. The whole of the remainder, $33 million, is long-term sterling debt requiring annual payments of only $200,000 and therefore presents no problem. There is no dollar foreign debt.
c) The present balance of payments deficit is due to poor harvests, a curtailed European demand for Portuguese luxury products (especially in U. K. and Germany) and the heavy capital goods imports mentioned above. These factors can be expected to decrease in intensity as more normal conditions return. In particular, traditional exports should expand as European austerity is relaxed, and imports will be much reduced when the investment program passes its peak.

d) The colonial empire has, in the past, provided Portugal with a substantial payments surplus, and in 1949/50, despite the import of $75 million of machinery and equipment, will have a trade deficit of only $58 million. As the investment program bears fruit the empire can be expected to reduce Portugal's need for imports and to expand exports of colonial products to other countries, including the dollar area, thus resuming its role as a foreign exchange earner but on a larger scale.

e) It is estimated that, out of Portugal's total foreign exchange receipts of $362 million in 1949-50, $126 million will be in gold and dollars. Since dollar imports are mainly such items as capital equipment, coal, petroleum and grains, there is great scope for substituting non-dollar for dollar imports as the European economy recovers; thus the present gold and dollar deficit ($107 million in 1949/50, assuming the full development program) will be progressively eliminated and might well be changed to a surplus.
f) On the basis of official price indices (black markets are held in check) there has been internal price stability since 1946. The public finances are being managed on sound lines; for the last twenty years the government has covered expenditure (some $230 million in 1947) out of revenue and borrowing, and in recent years has regularly shown a slight surplus despite the fact that extraordinary expenditure (including military expenditures, considerable public works and investment programs for agriculture, mining and industry) is now 65% as great as ordinary expenditure. The escudo has shown marked stability in the international exchange markets at about 25 escudos per dollar.

ii) Unfavourable Features

a) Portuguese exports are undeniably concentrated on wines, fish, cork and timber, which makes the country vulnerable to external economic changes. In particular it is very dependent on the fortunes of the rest of Europe since this is the main market for Portuguese wines and fruits.

b) Since the war, Portugal's balance of payments has been aided by substantial improvements in the terms of trade. A return to more normal conditions would undoubtedly have adverse effects.

c) The value and usefulness of the 55% of her foreign assets which is in blocked sterling is dependent upon the fortunes of the U.K.

d) Her rapidly expanding population means that, unless possibilities of emigration are developed, there will always be such pressure of population on resources that the standard of living can only
be maintained by successive investment programs requiring imported equipment. These may not always be economically feasible.

7. Taking all the above favourable and unfavourable features into account, it would appear that Portugal is in a favourable position compared with most other European countries, and that no conditions exist that would prima facie indicate her inability safely to incur, in the next few years, additional external obligations requiring annual service payments of up to $5 million, even if a large proportion of the debt should be in U. S. dollars. This figure is not meant, however, to set an upper limit to the extent of Portuguese borrowing so long as the projects financed ultimately improve the balance of payments position.